

Supplemental Letter of Findings Number: 02-20110301
Adjusted Gross Income Tax
For the Year 2007

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ISSUE

I. Adjusted Gross Income Tax—Consolidated Returns.

Authority: IC § 6-3-4-14; 15 U.S.C. § 381; I.R.C. § 166; Hunt Corp. v. Indiana Dep't of State Revenue, 709 N.E.2d 766 (Ind. Tax Ct. 1999).

Taxpayer protests the exclusion of two affiliated corporations in its consolidated income tax return based on the corporations' lack of activities in Indiana.

STATEMENT OF FACTS

Taxpayer is a corporation doing business in Indiana. Taxpayer filed a consolidated corporate income tax return on behalf of itself and two affiliated companies (collectively "Filing Group"; the affiliates shall be referred to as Member A, and Member B). Member A was the parent company for both Taxpayer and Member B.

The Indiana Department of Revenue ("Department") conducted an audit of Taxpayer. The Department's audit determined that Member A and Member B were not doing business in Indiana. In addition, the Department disallowed a research expense credit claimed by Taxpayer. As a result of these adjustments, the Department assessed Taxpayer additional corporate income tax. Taxpayer protested the assessment.

Previously, the Department issued a Letter of Findings denying Taxpayer's protest except with regard to a claimed research expense credit. Taxpayer requested—and the Department granted—a rehearing. The Department conducted a rehearing and this Supplemental Letter of Findings results.

I. Adjusted Gross Income Tax—Consolidated Group.

DISCUSSION

Taxpayer protests the exclusion of Member A and Member B from Taxpayer's Filing Group. In particular, Taxpayer argues that each of the companies should be included in the Filing Group. Member A was removed for the 2007 tax year. For 2003 through 2006, the Department removed Member A and Member B from the group in order to determine net operating loss carryforwards from these years to 2007. The issue is whether Member A and Member B have sufficient contacts with Indiana to allow the entities to be included in a consolidated return under IC § 6-3-4-14.

A consolidated return is filed on behalf of an affiliated group of corporations. Under IC § 6-3-4-14(b), "For the purposes of [IC § 6-3-4-14] the term 'affiliated group' shall mean an 'affiliated group' as defined in Section 1504 of the Internal Revenue Code with the exception that the affiliated group shall not include any corporation which does not have adjusted gross income derived from sources within the state of Indiana."

If Member A or Member B had no Indiana apportionment factors—property, payroll, and sales—then the affiliated corporation (i.e., Member A or Member B) would not be considered as doing business in Indiana pursuant to Hunt Corp. v. Indiana Dep't of State Revenue, 709 N.E.2d 766, 781 (Ind. Tax Ct. 1999) (disallowing the inclusion of two affiliated corporations when the corporations had no Indiana property, payroll, or receipts). However, solely for purposes of discussion, it will be assumed that Member A and/or Member B had Indiana-destination sales as separate companies.

For Member A, Taxpayer provided information that purports to show two alternative sets of facts. For one thing, Taxpayer provided additional information regarding Taxpayer and Member A's accounting. According to Taxpayer, the additional information demonstrates that Member A did not have any actual operations during 2007 and that Taxpayer actually received the income and incurred the expenses attributable to Member A. Thus, according to Taxpayer, the accounting issues would result in Taxpayer having actually earned the combined income and expenses previously reported by Taxpayer and Member A.

In the alternative, Taxpayer provided form W-2s issued by Taxpayer. However, according to Taxpayer, the W-2 forms partially represented payroll attributed to Member A. Taxpayer provided additional information to apparently attribute the employees provided to Member A's payroll.

In this case, Taxpayer has provided sufficient information to establish that Member A's reported operations were in fact a portion of Taxpayer's actual operations. The tax effect of the combination of operations is identical to the tax effect of Taxpayer's reporting of Taxpayer and Member A as part of an Indiana consolidated group. Thus, even though the Department does not necessarily agree that Member A had nexus with Indiana, Taxpayer's protest is sustained with regard to Member A.

However, the fact that Taxpayer's protest is sustained in this case should not be construed as the

Department's allowance of incomplete bookkeeping on the part of taxpayers. Taxpayer's records reflected all transactions for the tax year in question; however, the internal accounts to which the relevant expenses were attributed were themselves in error. The Department acted reasonably in its audit based on the information presented to the Department's auditor; however, Taxpayer provided information to correct its own previous error and substantiate its contention that this portion of the assessment should be abated.

With regard to Member B, Taxpayer stated that Member B's sales were made solely to Taxpayer. For the years at issue, Taxpayer asserts that Member B could not refuse product orders or instructions from Taxpayer. Taxpayer has also provided affidavits regarding Member B's Indiana contacts for the years in question. Based on the information provided, Taxpayer has provided sufficient information to conclude Member B's Indiana contacts exceeded the level of contact required by 15 U.S.C. § 381 (P.L. 86-272), which requires an out-of-state taxpayer to exceed mere solicitation in order to be subject to Indiana adjusted gross income taxes.

In this case, Member B has Indiana destination sales. However, those sales are eliminated because Member B's sole purchaser is in the same consolidated group as Member B. While the Department recognizes that inclusion or exclusion of Member B—and similarly situated corporations—each has merit, the Department is unable to conclude that Taxpayer has met its statutory burden of demonstrating that the assessment was incorrect.

In the alternative, Taxpayer provided information after the hearing that purports to show that, if Member B is not included in Taxpayer's consolidated group, that Taxpayer was entitled to a bad debt deduction under I.R.C. § 166 for amounts advanced to Member B. Other than a memorandum to the effect that the bad debt deduction should be permitted, Taxpayer has not provided documentation—or any other sufficient legal or factual grounds—to permit an adjustment for the claimed bad debt.

FINDING

Taxpayer's protest is sustained regarding the adjustments to Member A and denied regarding the adjustments to Member B.

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